

In the  
**United States Circuit Court of Appeals**  
**For the Seventh Circuit**

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No. 8130

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S. B. HEININGER,

*Petitioner,*

*vs.*

COMMISSIONER OF INTERNAL REVENUE,

*Respondent.*

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Petition for Review of Decision of the United States Board  
of Tax Appeals.

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1	S. B. Heininger, <i>Petitioner,</i> <i>vs.</i> Commissioner of Internal Revenue; <i>Respondent.</i>	}	Docket No. 106518.
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**Appearances:**

For Taxpayer: Earl B. Wilkinson, Esq., Samuel W. Witwer, Jr.

For Comm'r: D. A. Taylor, Esq.

**DOCKET ENTRIES.**

1941

Feb. 26—Petition received and filed. Taxpayer notified. (Fee paid.)

Feb. 26—Copy of petition served on General Counsel.

Mar. 7—Notice of appearance of Earl B. Wilkinson and Samuel W. Witwer, Jr., as counsel filed.

Apr. 10—Answer filed by General Counsel.

Apr. 10—Request for hearing in Chicago, Illinois, filed by General Counsel.

Apr. 17—Notice issued placing proceeding on Chicago, Illinois, Calendar. Service of answer and request made.

Oct. 13—Hearing set Dec. 1, 1941, Chicago, Illinois.

Dec. 4—Hearing had before Mr. Disney on merits. Submitted. Stipulation of facts filed. Briefs due Jan. 10, 1942; Replies Feb. 1, 1942.

Dec. 18—Transcript of hearing 12/4/41 filed.

1942

Jan. 10—Brief filed by General Counsel.

Jan. 12—Brief filed by taxpayer. (O. K. Mr. Disney's Office.) 1/13/42 copy served on General Counsel.

Feb. 2—Reply brief filed by taxpayer. 2/2/42 copy served on General Counsel.

June 10—Opinion rendered, Disney, Div. 4. Decision will be entered for the respondent. 6/12/42 copy served.

June 13—Decision entered, R. L. Disney, Div. 4.

Aug. 31—Petition for review by United States Circuit Court of Appeals, Seventh Circuit, filed by taxpayer.

Aug. 31—Statement of points filed by taxpayer.

Aug. 31—Statement of evidence filed.



Sept. 3—Proof of service of filing petition for review and statement of points filed.

Sept. 28—Designation of contents of record to be included in the record filed by taxpayer.

Oct. 5—Proof of service of filing designation of record filed by taxpayer.

Filed  
Feb. 26,  
1941.

2 BEFORE THE UNITED STATES BOARD OF TAX APPEALS.

S. B. Heininger,

*Petitioner,*

*vs.*

Commissioner of Internal Revenue,  
*Respondent.*

Docket No. 106518.

### PETITION.

Filed Feb. 26, 1941.

The above named petitioner hereby petitions for a re-determination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau Symbols SN:IT:1) dated December 3, 1940, and, as a basis of his proceeding, alleges as follows:

1. The petitioner is an individual residing at 1432 North La Salle Street, Chicago, Cook County, Illinois. The returns for the periods here involved were filed with the Collector for the First District of Illinois, at Chicago, Illinois.

2. The notice of deficiency, copy of which is attached hereto and marked Exhibit A, was mailed to petitioner on December 3, 1940, as petitioner believes.

3. The taxes in controversy are income taxes for the calendar years 1937 and 1938, and the proposed assessments are in the aggregate amount of \$15,176.01, with interest as provided by law.

4. The determination of the tax against petitioner, as set forth in said notice of deficiency, is based upon the following errors:

## Relating to the Calendar Year 1937.

(a) The Commissioner of Internal Revenue erroneously found that deposits on orders for artificial dentures unfilled as at December 31, 1937, aggregating \$20,593.60, received by petitioner from customers during 1937, were taxable in the year of receipt and that petitioner's income for 1937 should be increased in said amount.

(b) The Commissioner erred in failing to find and determine that petitioner did not earn or become entitled to said deposits of \$20,593.60, in the year 1937; that the Commissioner should have found and determined that not until the calendar year 1938, when petitioner filled certain of said orders and shipped artificial dentures to certain depositors did petitioner earn and become entitled to any part of said deposits or did any part thereof become income of petitioner.

(c) The Commissioner erred in failing to find and determine that under contract of sale with each depositor petitioner had no enforceable claim to said deposits of \$20,593.60 at any time during the year 1937; that the Commissioner should have found and determined that said depositors had an unconditional right throughout 1937 to a refund and restoration of all of said deposits aggregating \$20,593.60, and, accordingly, that it was impossible to determine in 1937 whether any part of said deposits constituted or would ever constitute income of petitioner.

(d) The Commissioner erroneously found and determined that \$7,706.99 paid by petitioner in 1937 for attorneys' fees in defending a proceeding instituted by the Postmaster General of the United States under 39 U. S. C. A. Section 259 and 732, to deprive petitioner of the use of the mails in his business, was not deductible from an income as an ordinary and necessary business expense.

(e) The Commissioner erred in failing to find and determine that said payment of \$7,706.99 for attorneys' fees made by petitioner in the year 1937 was an ordinary and necessary business expense and deductible from income in the year 1937.

(f) The Commissioner erroneously determined and assumed that said attorneys' fees of \$7,706.99 paid by petitioner in 1937 were for legal services in defense of a criminal charge, and erroneously determined and assumed for

said reason that said attorneys' fees were not deductible from income in 1937.

(g) The Commissioner erroneously determined and assumed that the said proceeding instituted by the Postmaster General of the United States against petitioner under U. S. C. A. Sections 259 and 732 and petitioner's suit to enjoin the enforcement of a "fraud order" issued by the Postmaster General, established that the petitioner's business in 1937 was unlawful; that the Commissioner should have found and determined that even if petitioner's business in 1937 were unlawful (which is hereby expressly denied) petitioner was entitled to deduct from income in 1937, as an ordinary and necessary expense of continuing and maintaining said business the said payment of \$7,706.99 for attorneys' fees.

#### Relating to the Year 1938

5 (h) The Commissioner of Internal Revenue erroneously found and determined that deposits on orders for artificial dentures, unfilled as at December 31, 1938, aggregating \$6,900.63 and received by petitioner from customers during 1938, were taxable in the year of receipt, and that petitioner's income for 1938 should be increased in said amount.

(i) The Commissioner erred in failing to find and determine that petitioner did not earn or become entitled to the said deposits of \$6,900.63 as his own property in the year 1938, and that Commissioner should have found and determined that not until the calendar year 1939, when petitioner filled certain of said orders and shipped artificial dentures to certain depositors did petitioner earn and become entitled to any part of said deposits or did any part thereof become income of petitioner.

(j) The Commissioner erred in failing to find and determine that under contract of sale with each depositor petitioner had no enforceable claim to said deposits of \$6,900.63 at any time during the year 1938; that the Commissioner should have found and determined that said depositors had an unconditional right throughout 1938 to a refund and restoration of all of said deposits aggregating \$6,900.63, and, accordingly, that it was impossible to determine in 1938 whether any part of said deposits constituted or would ever constitute income of petitioner.

(k) The Commissioner erroneously found and determined that the sum of \$29,530.56 paid by petitioner in 1938 for attorneys' fees in defending a proceeding instituted by the Postmaster General of the United States, under 6 39 U. S. C. A. Sections 259 and 732, and which resulted in the issuance of a "fraud order" in 1938 and in prosecuting a suit in the District Court of the United States for the District of Columbia, to enjoin the enforcement of said order, was not deductible from income in 1938 as an ordinary and necessary business expense.

(l) The Commissioner erred in failing to find and determine that said payment of \$29,530.56 by petitioner in the year 1938 for attorneys' fees was an ordinary and necessary business expense and deductible from income in 1938.

(m) The Commissioner erroneously determined and assumed that said attorneys' fees of \$29,530.56 paid by petitioner in 1938 were for legal services in defense of a criminal charge, and erroneously determined and assumed for said reason that said attorneys' fees were not deductible from income in 1938.

(n) The Commissioner erroneously determined and assumed that the said proceeding instituted by the Postmaster General of the United States against petitioner under U. S. C. A. Section 259 and 732, and petitioner's suit to enjoin the enforcement of a "fraud order" issued by the Postmaster General, established that the petitioner's business in 1938 was unlawful; that the Commissioner should have found and determined that even if petitioner's business in 1938 were unlawful (which is hereby expressly denied) petitioner was entitled to deduct from income, as an ordinary and necessary expense of continuing and maintaining said business, the said payment of \$29,530.56 for attorneys' fees.

(o) If deficiencies are assessed for the years 1937 7 and 1938, as proposed by the Commissioner, such action will be contrary to the provisions of the applicable Revenue Acts and in violation of the 5th and 16th Amendments to the Constitution of the United States.

5. The facts upon which petitioner relies as the basis of this proceeding are as follows:

The Facts With Reference to the Deposits on  
Unfiled Orders.

(a) During 1937 and 1938, petitioner's business consisted solely of the sale by mail of artificial dentures made by petitioner in Chicago, Illinois. During said years, petitioner advertised nationally, and upon receiving an inquiry from a prospective customer, petitioner mailed to him certain "first impression" material with instructions for use, and an order form suggesting remittance, with the order of a deposit of \$2.00. Upon receipt of the order, deposit and "first impression" material from the customer, petitioner forwarded to the customer certain "trays" with detailed instructions for taking additional mouth impressions. If the second impressions made on these "trays" proved unsatisfactory, new impression material was forwarded the customer, or in lieu thereof, the deposit was refunded when requested. The cost to petitioner of the "first impression" material and "trays" was a negligible part of the cost of the completed artificial denture. When impressions were approved by petitioner, then artificial dentures were constructed by petitioner and shipped C. O. D. to the customer for the balance of the price.

(b) To a large extent, the deposits of \$20,593.60 and \$6,900.63, held by petitioner at the close of the calendar years 1937 and 1938, respectively, represented the deposits received in the closing months of said years, respectively. Considerable time elapsed on the average order between the receipt of the deposit and the actual construction and shipment of the dentures. The deposits in question were on orders which were unfilled as of the close of the year in which the same were received by petitioner. On these orders no dentures were constructed and shipped by petitioner within the year of receipt and the respective sums deposited were neither earned by petitioner nor belonged to him by reason of any sale, as of the close of the respective calendar years. In many instances customers abandoned their purchases and requested and obtained promptly, refunds of their deposits. Petitioner entered all deposits in a "deposit account" and upon the completion of a particular sale, subsequently, he charged the "deposit account" and added the deposit on said sale to receipts.



(c) On December 31, 1937, the deposits on unfilled orders amounted to \$20,593.60, of which \$3,656.60 represented deposits received during the period from March 25, 1935 to December 31, 1936 on orders which were unfilled as at December 31, 1937. Said deposits of \$3,656.60 were erroneously included as income in petitioner's Returns for 1935 and 1936, and claim for refund has been filed with respect to the year 1936. During 1938, petitioner constructed and shipped artificial dentures to customers on orders received in 1937 and which were unfilled as of December 31, 1937 to extent permitting release of deposits in the amount of \$13,823.94. Thereupon, petitioner added said sum of \$13,823.94 to receipts for the year 1938.

9 During 1938, petitioner received deposits on orders unfilled as at December 31, 1938, amounting to \$6,900.63, and added said amount to the "deposit account." Accordingly, the amount of deposits on unfilled orders held by petitioner on December 31, 1938 was \$13,670.29.

(d) The printed order form provided that the artificial dentures were to be sold by petitioner on the basis of a sixty-day trial by the customer. The customer reserved the unconditional right to return the false teeth and recover his entire payment, including his deposit, at any time within sixty days following the delivery to him of the dentures. Many customers exercised their right of refund, both before and after construction and shipment of the artificial dentures, and the petitioner promptly restored to such customers the amounts deposited. With respect to the deposits in question in the years 1937 and 1938, no artificial dentures were constructed and shipped on said orders within the respective years in which said deposits were received and whether or not such deposits would ever constitute taxable income to petitioner could not be determined in the respective years of receipt.

(e) During part of 1937 and throughout 1938 petitioner defended a proceeding instituted by the Postmaster General of the United States to deprive petitioner of the use of the mails. During the pendency of said proceeding, petitioner was faced with the possibility that a "fraud" order might be entered and his business be terminated over-night. This condition with the other factors mentioned made it impossible to determine in the respective  
10 years of receipt whether said deposits constituted or would ever constitute income.

**The Facts Regarding the Right to Deduct From Income the Attorneys' Fees Paid by Petitioner During the Years 1937 and 1938.**

(f) On September 22, 1937, a citation was issued by the Solicitor of the Post Office Department, charging that petitioner's business constituted a scheme for obtaining funds through the mails by means of false and fraudulent pretenses, in violation of 39 U. S. C. A. Sections 259 and 732. Thereafter, petitioner answered said charges and employed attorneys in resisting said proceeding. Petitioner paid said attorneys in 1937 fees amounting to \$7,069.99.

(g) On February 19, 1938, the Postmaster General of the United States issued a "fraud order" forbidding the Postmaster at Chicago, Illinois, to pay any money orders drawn to the order of petitioner; and instructing said Postmaster to return all mail addressed to the petitioner, marked "Fraudulent". Thereupon, petitioner filed suit in the District Court of the United States for the District of Columbia against James A. Farley, Postmaster General, and on that date said court entered an order directing the Postmaster General to hold all mail addressed to petitioner until the further order of Court.

(h) On June 3, 1938, the District Court of the United States for the District of Columbia granted to petitioner a permanent injunction and found that the "fraud order" of February 19, 1938 was null and void, and that the plaintiff was engaged in a lawful business. Thereafter, the

Postmaster General appealed to the United States

11 Court of Appeals for the District of Columbia, and

on April 17, 1939 that Court reversed the order of the District Court for the District of Columbia and remanded the cause with instructions to dissolve the injunction and to dismiss the Bill of Complaint (105 Fed. 2nd. 79). In its opinion, the Court of Appeals made no finding that the petitioner was engaged in a fraudulent business, but held that the only question before it was whether the conclusion of the Postmaster General was supported by "substantial" evidence; which the Circuit Court found to be the case.

Thereafter, in 1939 the petitioner applied to the Supreme Court of the United States for a Writ of Certiorari to review the judgment of the United States Court of Appeals, which petition was denied. Petitioner has not since engaged in business of selling artificial dentures.

(i) During 1938, petitioner paid \$29,530.56 for legal services in resisting the proceeding brought by the Postmaster General which culminated in the "fraud order", in prosecuting his injunction suit in the District Court of the United States for the District of Columbia and defending the said appeal of the Postmaster General to the Circuit Court of Appeals for the District of Columbia.

(j) If petitioner had not engaged attorneys and expended said sums in 1937 and 1938, he would have been forced to discontinue his business on February 19, 1938, and there would have been no net income of petitioner in 1938 upon which to pay an income tax. Said payments of attorneys' fees were not only ordinary and necessary business expenses but they were essential to the continuance of petitioner's business in the years 1937 and 1938 and were proximately related to said business.

Wherefore, petitioner prays that this Board hear this proceeding and redetermine the alleged deficiency and find and adjudge that said deficiency proposed by the Commissioner of Internal Revenue with respect to the years 1937 and 1938 is without foundation in fact and law.

S. B. Heininger.

Earl B. Wilkinson,  
Floyd L. Lanham,  
Samuel W. Witwer, Jr.,  
231 S. La Salle Street,  
Chicago, Illinois.

13 State of Illinois, }  
County of Cook. } ss.

S. B. Heininger, being first duly sworn, on oath deposes and says that he is the subscriber to the foregoing petition; that he has read the foregoing petition and is familiar with the statements contained therein, and that the statements therein made are true.

S. B. Heininger.

Subscribed and sworn to before me this 31st day of January, A. D. 1941.

Lolita A. Conway,  
Notary Public.

(Seal)

My Commission expires: March 19, 1944.



10

*Exhibit A.*

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**EXHIBIT A.**

**SN-IT-1**

**TREASURY DEPARTMENT  
Internal Revenue Service  
Chicago, Illinois**

**Form 1230**

**Dec. 3, 1940.**

**Office of  
Internal Revenue Agent in Charge  
Chicago Division  
Room 1100, 105 West Adams Street  
Mr. S. B. Heininger  
706 North Hudson Street  
Chicago, Illinois**

**Sir:**

You are advised that the determination of your income tax liability for the taxable year(s) ended December 31, 1937 and 1938 discloses a deficiency of \$15,176.01 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Chicago, Illinois, for the attention of SN:IT. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

**Respectfully,**

**Guy T. Helvering,**

*Commissioner,*

**Enclosures:**

**Statement**

**Form of Waiver**

**Form 272M**

**MA:GS**

**By (Signed) E. C. Wright,  
Internal Revenue Agent  
in Charge.**

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## Statement.

SN:IT

Mr. S. B. Heininger  
706 North Hudson Street  
Chicago, Illinois

Tax Liability for the Taxable Years Ended December 31,  
1937 and 1938.

## Income Tax

Year	Liability	Assessed	Deficiency
1937	\$18,521.76	\$7,705.14	\$10,816.62
1938	4,978.16	618.77	4,359.39
Totals	\$23,499.92	\$8,323.91	\$15,176.01

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated November 17, 1939; to your protest dated January 20, 1940; and to the statements made at the conferences held on February 7, 1940, February 10, 1940, and May 17, 1940.

If you do not acquiesce in all of the adjustments making up the deficiency indicated, but desire to stop the accumulation of interest on that part of the deficiency resulting from adjustments to which you agree, please fill out the enclosed form of waiver, inserting therein the amount of deficiency you desire to have assessed at once. The execution of the form for the agreed portion of the deficiency will not deprive you of your right to petition the United States Board of Tax Appeals for a redetermination of the deficiency.

## Taxable Year Ended December 31, 1937.

## Adjustments to Net Income.

Net income as disclosed by return	\$46,952.08
Unallowable deductions and additional income	
(a) Income from business	28,300.59
Net income adjusted	\$75,252.67

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## Explanations of Adjustments.

(a) Prior to 1937 you reported as income in each year all amounts received as deposits on orders for dentures which were unfilled at the close of the year. In the returns filed for the years 1937 and 1938, such amounts were omitted from income. It is held that in accordance with the provisions of Article 41-1 of Regulations 94, such amounts are taxable in the year in which received. Accordingly, your income for 1937 has been increased by \$20,593.60.

It is held that the amount of \$7,706.99 paid by you in the year 1937 for legal expenses is not deductible from income. The amount was expended in defense of a proceeding brought against you by the Postmaster General of the United States under authority of the laws relating to the Postal Service, which resulted in the issuance of a "desist" order in 1938, and your unsuccessful suit to enjoin its enforcement was terminated in 1939 when the Supreme Court denied certiorari.

Earned income credit claimed in your return in the amount of \$936.04 has been increased to \$1,400.00, the amount allowable under the provisions of sections 25(a)(3) and (4) of the Revenue Act of 1936.

## Computation of Tax.

Net income adjusted		\$75,252.67
Less:		
Personal exemption	\$2,500.00	
Credit for dependents	800.00	3,300.00
Balance (surtax net income)		\$71,952.67
Less:		
Earned income credit (10% of \$14,000)		1,400.00
Net income subject to normal tax		\$70,552.67
Normal tax at 4% on \$70,552.67		2,822.11
Surtax on \$67,952.67 (amount in excess of \$4,000)		15,699.65
Total tax		\$18,521.76
17 Less:		
Income tax paid at the source		None
Correct income tax liability		\$18,521.76
Income tax assessed:		
Original, account No. 205471		7,705.14
Deficiency of income tax		\$10,816.62

Taxable Year Ended December 31, 1938.  
Adjustments to Net Income.

Net income as disclosed by return		\$12,274.39
Unallowable deductions and additional income		
(a) Income from business	\$22,972.83	
(b) Dividends	350.00	
(c) Loss on exchange of automobile	754.25	24,077.08
Net income adjusted		\$36,351.47

Explanation of Adjustments.

(a) Prior to 1937 you reported as income in each year all amounts received as deposits on orders for dentures which were unfilled at the close of the year. In the returns filed for the years 1937 and 1938, such amounts were omitted from income. It is held that in accordance with the provisions of Article 41-1 of Regulations 101, such amounts are taxable in the year in which received. Accordingly, your income for 1938 has been decreased by \$13,823.94, which represents deposits reported as income by you in that year, which should have been included in the prior year, less \$6,900.63 representing deposits collected at the close of the year 1938 and now included as income in that year, or a net difference of \$6,923.31.

18 It is held that the amount of \$29,530.56 paid by you in the year 1938 for legal expenses is not deductible from income. The amount was expended in defense of a proceeding brought against you by the Postmaster General of the United States under authority of the laws relating to the Postal Service, which resulted in the issuance of a "desist" order in 1938, and your unsuccessful suit to enjoin its enforcement was terminated in 1939 when the Supreme Court denied certiorari.

The amount of \$365.58 legal fees, included in deductions in your return, has been disallowed for the reason that it was paid for services rendered another company and, therefore, is not deductible by you under any of the provisions of section 23 of the Revenue Act of 1938.

(b) Dividends reported in your return in the amount

of \$875.00 have been increased to \$1,225.00, the amount received during the taxable year from the United States Steel Corporation, and taxable under the provisions of Section 22(a) of the Revenue Act of 1938.

(c) The loss claimed on line 19(c) of your return in the amount of \$754.25 as sustained on an automobile, which was traded in on another automobile, has been disallowed for the reason that no loss is recognized on exchanges solely in kind, in accordance with the provisions of section 112(b)1 of the Revenue Act of 1938.

Earned income credit claimed in your return in the amount of \$300.00 has been increased to \$701.03, the amount allowable under the provisions of section 25(a) (3) and (4) of the Revenue Act of 1938.

### Computation of Tax.

Net income adjusted		\$36,351.47
Less:		
Personal exemption	\$2,500.00	
Credit for dependents	466.67	2,966.67
		<hr/>
Balance (surtax net income)		\$33,384.80
Less:		
Earned income credit		701.03
		<hr/>
Net income subject to normal tax		\$32,683.77
19 Normal tax at 4% on \$32,683.77		1,307.35
Surtax on \$29,284.80 (amount in excess of \$4,000)		3,670.81
		<hr/>
Total normal tax and surtax		\$ 4,978.16
Less:		
Income tax paid at source		none
		<hr/>
Correct income tax liability		\$ 4,978.16
Income tax assessed:		
Original, account No. 828743		618.77
		<hr/>
Deficiency of income tax		\$ 4,359.39

## ANSWER.

(Filed Apr. 10, 1941.)

Comes now the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed in the above-entitled cause admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4. (a) to (o), incl. Denies the allegations of error contained in subparagraphs (a) to (o), inclusive, of paragraph 4 of the petition.

5. (a) and (b) Denies the allegations of fact contained in subparagraphs (a) and (b) of paragraph 5 of the petition.

5. (c) Admits that at December 31, 1937 deposits on unfilled orders received by the petitioner amounted to \$20,593.60 and that deposits on the unfilled orders at December 31, 1938 amounted to \$6,900.63 as alleged in subparagraph (c) of paragraph 5 of the petition. Denies the remaining allegations contained in subparagraph (c) of paragraph 5 of the petition.

5. (d) Denies the allegations of fact contained in subparagraph (d) of paragraph 5 of the petition.

5. (e) Admits that during part of 1937 and throughout 1938 petitioner defended a proceeding instituted by the Postmaster General of the United States to deprive petitioner of the use of the mails. Denies the remaining allegations contained in subparagraph (e) of paragraph 5 of the petition.

5. (f) and (g) Admits the allegations contained in subparagraphs (f) and (g) of paragraph 5 of the petition.

5. (h) Admits that on June 3, 1938 the District Court of the United States for the District of Columbia granted to petitioner a permanent injunction; that thereafter the



Postmaster General appealed to the United States Court of Appeals for the District of Columbia and on April 17, 1939 that Court reversed the order of the District Court for the District of Columbia and remanded the cause with instructions to dissolve the injunction and to dismiss the Bill of Complaint; and that thereafter in 1939 the petitioner applied to the Supreme Court of the United States for a writ of certiorari to review the judgment of the United States Court of Appeals which petition was denied.

Denies the remaining allegations of fact contained in subparagraph (h) of paragraph 5 of the petition.

5. (i) Admits the allegations contained in subparagraph (i) of paragraph 5 of the petition.

5. (j) Denies the allegations contained in subparagraph (j) of paragraph 5 of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore admitted, qualified or denied.

Wherefore, respondent prays that the Board redetermine the deficiency herein to be the amount determined by the Commissioner, viz.: \$15,176.01.

(Signed) J. P. Wenchel BAT

J. P. Wenchel,

*Chief Counsel, Bureau of  
Internal Revenue.*

Of Counsel:

F. R. Shearer,

*Division Counsel.*

Gerald W. Broome,

Rollin H. Transue,

*Special Attorneys,*

*Bureau of Internal Revenue.*

## 23 BEFORE THE UNITED STATES BOARD OF TAX APPEALS.

• • (Caption—106518) • •

## STATEMENT OF EVIDENCE.

(Filed August 31.)

The above entitled cause came on for hearing at Chicago, Illinois, before the Honorable Richard L. Disney, member of the United States Board of Tax Appeals, on the 4th day of December, A. D. 1941, and Samuel W. Witwer, Jr, appeared on behalf of petitioner, and D. A. Taylor, Esq., appeared on behalf of respondent. Thereupon, the following proceedings were had and the parties by their attorneys submitted the following evidence:

1. The petitioner, S. B. Heininger, was a resident of Chicago, Illinois, at the time of the filing of the petition herein. Petitioner now resides at Athens, Wisconsin. The returns for the periods here involved were filed with the Collector of Internal Revenue for the First District of Illinois, at Chicago, Illinois.

24 2. On December 3, 1940, the respondent mailed to petitioner a notice of deficiency in federal income taxes for the years 1937 and 1938.

3. The taxes in controversy are income taxes for the calendar years 1937 and 1938, and the deficiencies asserted are in the amounts of \$10,816.62 and \$4,359.39, respectively.

4. During the years from about 1926 to 1939, petitioner was a licensed dentist in the State of Illinois. His principal work since about 1932 was the making of artificial dentures, commonly known as false teeth, for customers living outside of the City of Chicago who did not personally visit petitioner's office.

5. On September 22, 1937 a citation was issued by the Solicitor of the Post Office Department, charging that petitioner was engaged in conducting a scheme for obtaining funds through the mails by means of false and fraudulent practices, in violation of 39 U. S. C. A., Sections 259 and 732. Shortly thereafter petitioner appeared before the United States Post Office Department, answered said charges and employed attorneys to render legal services to petitioner in resisting the issuance of the so-called "Fraud Order" under said Statute. During 1937 peti-



tioner paid attorneys' fees and other legal expenses in  
25 connection with said proceedings, amounting to \$7,-  
069.99; said payments were reasonable in amount.

6. On February 19, 1938, and after hearing under the aforesaid citation, the Postmaster General of the United States issued a so-called "Fraud Order," forbidding the Postmaster at Chicago, Illinois, to pay any money orders drawn to the order of petitioner, and instructing said Postmaster to return all mail addressed to the petitioner to the senders, marked "Fraudulent." Thereafter, on February 25, 1938, petitioner filed suit in the District Court of the United States for the District of Columbia against James A. Farley, Postmaster General, and on that date said Court entered an order directing the Postmaster General to hold all mail addressed to petitioner until the further order of the Court.

7. On June 6, 1938, the District Court of the United States for the District of Columbia granted to petitioner a permanent injunction, restraining the Postmaster General of the United States from enforcing the aforesaid "Fraud Order" or otherwise proceeding in accordance with the terms of said "Fraud Order." Thereafter the Postmaster General appealed said case to the Court of Appeals for the District of Columbia, and on April 17, 1939 that Court reversed the Order of the District Court  
26 for the District of Columbia and remanded the cause  
with instructions to dissolve the injunction and to  
dismiss the Bill of Complaint. Thereafter, in the  
October Term, A. D. 1939, petitioner applied to the Supreme Court of the United States for a Writ of Certiorari to review the judgment of the United States Court of Appeals, which Petition for Certiorari was denied.

8. Pursuant to mandate of the aforesaid Court of Appeals, the said District Court entered an order dissolving the aforesaid injunction and dismissing the aforesaid Bill of Complaint. Said order is now final and in full force and effect.

9. During the year 1938 petitioner paid to attorneys for legal services in prosecuting his injunction suit in the District Court of the United States for the District of Columbia, and defending the aforesaid appeal of the Postmaster General to the Circuit Court of Appeals for the District of Columbia, and in applying to the Supreme Court of the United States for Writ of Certiorari, fees

and legal expenses aggregating \$29,530.56; said payments were reasonable in amount.

(The foregoing evidence contained in a Stipulation of Facts, which was entered into by and between the petitioner and respondent and filed herein, is material to this review. Other evidence contained in said stipulation is omitted here as immaterial.)

27 S. B. Heininger, petitioner, testified that he presently resides at Athens, Wisconsin, but that he resided in Chicago at the time of the filing of the petition for redetermination before the Board of Tax Appeals. His business in the years 1937 and 1938 consisted of the manufacture and sale of false teeth by mail. This was his sole business except from February 19, 1938 to July 6, 1938, during which period petitioner was prevented from engaging in business by reason of the Post Office Order.

The evidence shows that petitioner conducted his said business as follows:

On receiving an inquiry by mail from a prospective customer, petitioner mailed to him a portion of wax known as a first impression material, together with an order blank, catalog of prices, and instructions regarding the use of the wax. This wax impression material was then returned to petitioner by mail and examined by petitioner, who thereupon chose a suitable "tray" and the right amount of impression material and returned this "tray" by mail to the customer with instructions for use. The customer then returned the "tray" to petitioner by mail with a second impression of his mouth. Petitioner then examined the "tray" and if it gave a satisfactory impression, proceeded to make the upper plate. If the impression was not satisfactory petitioner mailed additional material to the customer with further instructions in order to

28 obtain a better impression. Upon receiving the impression, the petitioner would examine it again and if it was satisfactory he would then proceed to make a plate, in some cases trying as many as four times to obtain a satisfactory impression. If upon the fourth attempt, the impression on the "tray" was not satisfactory, petitioner discontinued the procedure and mailed to the customer the initial deposit which accompanied the order for the artificial dentures. If the impression was satisfactory, he finished the upper plate and sent it out c. o. d. for the price of the upper plate only, together with a wax "bite" for petitioner's use in preparing the lower plate. Upon re-

ceiving the lower plate "bite", petitioner would commence construction of the lower plate and finish and mail it to the customer c. o. d.

Petitioner rendered no dentistry services in his office during 1937 and 1938, and did not have a dentist's chair there. He manufactured and shipped artificial dentures to customers who sent him orders from all States in the Union, other than Illinois.

Thereupon, counsel for the petitioner offered and there were received in evidence and marked Petitioner's Exhibits 3, 4 and 5, being order blanks used by petitioner during the years 1937 and 1938 on all sales of artificial dentures manufactured and shipped by him during said years.

The petitioner's Exhibits 1 and 2, and respondent's Exhibit A are omitted as immaterial and unnecessary for consideration of the questions presented for review.

(The foregoing was all of the evidence offered by petitioner and the respondent in this cause which is material and necessary for consideration of the questions presented for review.)

Thereupon, counsel for petitioner and counsel for respondent stated that they had no further evidence to present and submitted the case to a member of the United States Board of Tax Appeals presiding during the hearing. True copies of petitioner's Exhibits 3, 4 and 5, which were introduced in evidence at the hearing, are attached hereto and made a part of this Statement of Evidence.

Petitioner, S. B. Heininger, tenders and presents the foregoing as his Statement of Evidence in this case, and prays that same may be approved by the United States Board of Tax Appeals and made a part of the record in this cause.

Lloyd L. Lanham,  
Samuel W. Witwer, Jr.

Dated: August 28, 1942.

30

PETITIONER'S EXHIBIT 3.

60 Day Trial Blank

Date .....

Dr. S. B. Heininger, D. D. S.  
440 W. Huron Street  
Chicago, Illinois

Dear Doctor:

1. Enclosed find \$..... Please rush plates as soon as possible. 2. Age..... Color of hair..... 3. Color of eyes..... Complexion: dark, medium or light.....  
5. How long have teeth been out?..... 6. Have you worn plates before?..... 7. Are you wearing an upper or a lower plate now?..... 8. Have you any natural teeth in your mouth now? If so, are they in the lower or the upper jaw?..... 9. Were your natural teeth small, medium or large in size?.....

Plate Wanted: (Mark with X in square)

Style No. ....	Upper <input type="checkbox"/>	Lower <input type="checkbox"/>	Full Set <input type="checkbox"/>
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Be sure to give Style Number

Remarks: .....

Name ..... Street Address .....  
Post Office ..... State ..... R. F. D. .... Box .....

Please order your plates according to this trial blank. If you prefer or cannot send the full amount, just send \$2.00 as a deposit and I will send plates C. O. D. for the Balance. You take no risk in sending full amount as you can try them for 60 days and I absolutely guarantee satisfaction or refund your money. You are the sole judge. I take your word.

Dr. S. B. Heininger, D. D. S.

## PETITIONER'S EXHIBIT 4.

Special Offer for 15 Days Only

60 Day Trial Blank

Date.....

Dr. S. B. Heininger, D. D. S.  
 440 W. Huron Street  
 Chicago, Illinois

Dear Doctor:

1. Enclosed find \$..... Please rush plates as soon as possible. 2. Age..... Color of hair..... 3. Color of eyes..... Complexion: dark, medium or light..... 5. How long have teeth been out?..... 6. Have you worn plates before?..... 7. Are you wearing an upper or a lower plate now?..... 8. Have you any natural teeth in your mouth now? If so, are they in the lower or the upper jaw?..... 9. Were your natural teeth small, medium or large in size?.....

Plate Wanted:

(Mark with X in square)

Style No. ....	Upper <input type="checkbox"/>	Lower <input type="checkbox"/>	Full Set <input type="checkbox"/>
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Be sure to give Style Number

Remarks: .....

Name ..... Street Address .....

Post Office ..... State ..... R. F. D. .... Box .....

Please order your plates according to this trial blank. If you prefer or cannot send the full amount, just send \$2.00 as a deposit and I will send plates C. O. D. for the Balance. You take no risk in sending full amount as you can try them for 60 days and I absolutely guarantee satisfaction or refund your money. You are the sole judge. I take your word.

Dr. S. B. Heininger, D. D. S.



Important

Before mailing this order blank, be sure that you have filled in the Style of Plate wanted—also, whether you wish an Upper or Lower Plate or Complete Set.

Pledge Card:

Date.....

Dr. Heininger:

I promise to show my teeth to at least two of my friends. I will tell where I purchased them and how they can go about getting a set like the ones I have.

Signed.....

Your Signature Here Is Important

32

PETITIONER'S EXHIBIT 5.

60 Day Trial Blank

Date.....

S. B. Heininger

440 W. Huron Street, Chicago, Illinois

Dear Sirs:

1. Enclosed find \$..... Please rush plates as soon as possible. 2. Age..... Color of hair..... 3. Color of eyes..... 4. Complexion: dark, medium or light..... 5. How long have teeth been out?..... 6. Have you worn plates before?..... 7. Are you wearing an upper or a lower plate now?..... 8. Have you any natural teeth in your mouth now? If so, are they in the lower or the upper jaw?..... 9. Were your natural teeth small, medium or large in size?..... Were your natural teeth protrusive, retrusive or perpendicular?.....

Plate Wanted:

(Mark with X in square)

Style No. ....	Upper <input type="checkbox"/>	Lower <input type="checkbox"/>	Full Set <input type="checkbox"/>
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Be sure to give Style Number

Remarks: .....

Name..... Street Address.....

Post Office..... State..... R. F. D..... Box.....

Please order your plates according to this trial blank. Just send \$2.00 or more as a deposit and we will send the plates C. O. D. for balance. Please do not send in the full amount as we prefer to send plates C. O. D. for some balance. You take absolutely no risk as you can try these teeth for 60 days with guaranteed satisfaction in every way or your money will be refunded. You are the sole judge. We take your word.

Yours truly,  
S. B. Heininger

Filed 33  
June 10,  
1942.

UNITED STATES BOARD OF TAX APPEALS

S. B. Heininger, Petitioner, vs. Commissioner of Internal Revenue, Respondent.

Docket No. 106518. Promulgated June 10, 1942.

1. Petitioner, engaged in selling false teeth by mail, received initial deposits from customers under a written promise to refund all moneys in case of dissatisfaction after 60 days' trial. The deposits were placed, with other amounts paid, in petitioner's only bank account. The orders for false teeth had not been filled or completed at the end of the taxable years. *Held*, that the liability to refund was only contingent and that the deposits constituted income.

2. Petitioner expended moneys to resist issuance of a "fraud order" by the Postmaster General, barring his use of the mails, also in obtaining an injunction against the fraud order, resisting appeal therefrom, and unsuccessfully applying to the Supreme Court for certiorari after the Circuit Court had reversed the granting of the injunction. *Held*, such expense was not ordinary and necessary expense of trade or business. *National Outdoor Advertising Bureau v. Helvering*, 89 Fed. (2d) 878, followed.

*Samuel W. Witwer, Jr., Esq.*, for the petitioner.

*D. A. Taylor, Esq.*, for the respondent.

## OPINION.

DISNEY: The present proceeding involves income taxes for the calendar years 1937 and 1938. The Commissioner determined deficiencies in the respective amounts of \$10,816.62 and \$4,359.39. The petitioner urges error as to the major portion of the amounts. The questions presented are whether certain amounts received by the petitioner were properly added to gross income, and whether certain attorney fees were deductible as ordinary and necessary expenses of business. The income tax returns involved were filed with the collector for the first district of Illinois at Chicago, Illinois. The greater portion of the facts have been stipulated, as follows:

1. The petitioner, S. B. Heininger, was a resident of Chicago, Illinois, at the time of the filing of the petition herein. Petitioner now resides at Athens, Wisconsin. The returns for the periods here involved were filed with 34 the Collector of Internal Revenue for the First District of Illinois, at Chicago, Illinois.
2. On December 3, 1940, the respondent mailed to petitioner a notice of deficiency in federal income taxes for the years 1937 and 1938, a true and correct copy of which is attached as Exhibit A to the petition herein.
3. The taxes in controversy are income taxes for the calendar years 1937 and 1938, and the deficiencies asserted are in the amounts of \$10,816.62 and \$4,359.39, respectively.
4. During the years from about 1926 to 1939, the petitioner was a licensed dentist in the State of Illinois. His principal work since about 1932 was the making of artificial dentures, commonly known as false teeth, for customers living outside of the City of Chicago who did not personally visit petitioner's office. Before said dentures were made for a customer, petitioner required from and there was forwarded to him from such customer a payment of \$2.00 generally designated by the petitioner and hereinafter for convenience referred to as "deposit". Said dentures, when completed for said nonresident customers, were mailed or shipped to them, C. O. D., for the amount of petitioner's respective charges less the \$2.00 "deposit". For various reasons some of the "deposits" were returned to said clients and the dentures ordered by them were not furnished by the petitioner. For years prior to the year 1937, the petitioner consistently followed the practice of



entering said "deposits" in his books of account as gross receipts when received, against which he entered as offsets thereto when returned the amounts of the "deposits" returned, and reflected the difference as gross income in his income tax returns for those years.

5. Petitioner's books of account for the years 1937 and 1938 recorded aforesaid "deposits" and said "deposits" returned and gross income as set forth in paragraph 4, *supra*. On December 31, 1937, the petitioner credited to a "deposit account" an item of \$20,593.60 representing "deposits" on orders which had not been filled or completed. Of said amount, \$3,656.60 represented "deposits" received during the period prior to January 1, 1937, and \$16,937.00 represented "deposits" received during the year 1937. Said item of \$20,593.60 was deducted from petitioner's gross income arrived at as set forth, *supra*, in his income tax return filed for the year 1937. On December 31, 1938 the petitioner credited to said "deposit account" an item of \$6,900.63 representing "deposits" received during the year 1938. During the year 1938 the petitioner completed, mailed and/or shipped dentures on which deposits in the amount of \$13,823.94 had been made in prior years and which were included in the said item of \$20,593.60. On December 31, 1938 said "deposit account" was charged with said item of \$13,823.94 and gross receipts for 1938 were increased in a like amount, leaving in said "deposit account" as of January 1, 1939 the amount of \$13,670.29 (\$20,593.60 minus \$13,823.94 plus \$6,900.63) representing deposits on orders for dentures unfilled as of that date. In petitioner's income tax return for said year 1938 the aforesaid item of \$13,823.94 was included in gross income and the said item of \$6,900.63 was deducted from gross income.

In the respondent's final determination of the petitioner's tax liability for said year 1937, as evidenced by his notice of deficiency, a copy of which is attached to the petition herein as Exhibit A, the respondent disallowed as a deduction the said item of \$3,656.60 and included in gross income the said item of \$16,937.00. The petitioner concedes that the respondent's action in disallowing the said deduction of \$3,656.60 was proper and in the final determination herein of petitioner's tax liability for the said year, said deduction should be disallowed.

In the respondent's final determination of the deficiency herein for the said year 1938, as evidenced by his notice

of deficiency, a copy of which is attached to the petition  
35 herein as Exhibit A, the respondent eliminated from  
gross income the said item of \$13,823.94 and included  
in petitioner's gross income the said item of \$6,900.63.

6. Petitioner's income tax returns were at all times  
filed on the cash receipts and disbursements basis. The  
petitioner never applied for nor received permission from  
the Commissioner of Internal Revenue to change his method  
of accounting or filing his income tax returns employed  
for years prior to 1937.

7. On September 22, 1937 a citation was issued by the  
Solicitor of the Post Office Department, charging that peti-  
tioner was engaged in conducting a scheme for obtaining  
funds through the mails by means of false and fraudulent  
practices, in violation of 39 U. S. C. A., Sections 259 and  
732. Shortly thereafter petitioner appeared before the  
United States Post Office Department, answered said  
charges and employed attorneys to render legal services  
to petitioner in resisting the issuance of the so-called  
"Fraud Order" under said Statute. During 1937 petitioner  
paid attorneys' fees and other legal expenses in connection  
with said proceedings, amounting to \$7,069.99; said pay-  
ments were reasonable in amount.

8. On February 19, 1938, and after a hearing under  
the aforesaid citation, the Postmaster-General of the United  
States issued a so-called "Fraud Order," forbidding the  
Postmaster at Chicago, Illinois, to pay any money orders  
drawn to the order of petitioner, and instructing said  
Postmaster to return all mail addressed to the petitioner,  
to the senders, marked "Fraudulent". Thereafter, on  
February 25, 1938, petitioner filed suit in the District Court  
of the United States for the District of Columbia against  
James A. Farley, Postmaster General, and on that date  
said Court entered an order directing the Postmaster Gen-  
eral to hold all mail addressed to petitioner until the fur-  
ther order of the Court.

9. On June 6, 1938, the District Court of the United  
States for the District of Columbia granted to petitioner a  
permanent injunction, restraining the Postmaster General  
of the United States from enforcing the aforesaid "Fraud  
Order" or otherwise proceeding in accordance with the  
terms of said "Fraud Order". Thereafter the Postmaster  
General appealed said case to the Court of Appeals for  
the District of Columbia, and on April 17, 1939 that Court  
reversed the Order of the District Court for the District

of Columbia and remanded the cause with instructions to dissolve the injunction and to dismiss the Bill of Complaint. The opinion of the said Court of Appeals is reported at 105 Fed. 2d 79, of which this Board may take judicial notice. Thereafter, in the October Term, A. D. 1939, petitioner applied to the Supreme Court of the United States for a Writ of Certiorari to review the judgment of the United States Court of Appeals, which Petition for Certiorari was denied.

10. A copy of the Bill of Complaint filed by the petitioner in said District Court including a copy of the aforesaid "Fraud Order" attached thereto as "Exhibit A"; a copy of the Answer thereto; a copy of the Restraint Order entered by the said District Court; a copy of the Court's opinion; and a copy of the Court's order of permanent injunction are set forth in "Exhibit A", as labeled therein, which is attached hereto and made a part hereof.

11. Pursuant to mandate of the aforesaid injunction and dismissing the aforesaid Bill of Complaint. Said order is now final and in full force and effect.

12. During the year 1938 petitioner paid to attorneys for legal services in prosecuting his injunction suit in the District Court of the United States for the District of Columbia, and defending the aforesaid appeal of the Postmaster General to the Circuit Court of Appeals for the District of Columbia, and in applying to the Supreme Court of the United States for Writ of Certiorari, fees and legal expenses aggregating \$29,530.56; said payments were reasonable in amount.

36 We find the facts to be as stipulated. In addition, from evidence adduced, we further find:

The petitioner on receiving an inquiry by mail customarily mailed a portion of wax called "first impression" material with an order blank and catalogue of prices and instructions as to how to use the wax. The customer would return it with an impression of the teeth, and was then furnished with material for a second impression. If this was satisfactory, the upper plate was made. If not satisfactory, further material was sent to get a better impression. If upon a fourth effort a satisfactory impression was not secured the procedure was discontinued and the deposit mailed back to the customer. If finally satisfactory, the upper plate was finished and sent c. o. d. for the price of the upper plate only, with wax for an impression

for the lower plate which in like manner was finished and sent c. o. d. The petitioner's gross receipts from the dental business in the year 1937 were \$287,582.82 and in 1938 were \$150,168.27. Refunds made in 1938 were \$27,349 and for the year 1937 were \$38,062.08. The petitioner had only one bank account, upon which he drew to pay operating expenses and refunds which were made whenever customers asked for them, whether before or after the completion of the dentures, if the customer was not satisfied. This was pursuant to a written statement included in the order blank used, to the effect that satisfaction was guaranteed or the customer's money would be refunded after a trial of the teeth of 60 days.

1. We first consider the question whether the Commissioner erred in including in petitioner's gross income amounts received by petitioner as deposits upon dental work ordered from him by mail, under a written agreement, embodied in the order blank used by the customer, that his money would be refunded in case of dissatisfaction. The petitioner of course has the burden of showing respondent's action to be error. Petitioner in substance contends that there was, in each of the taxable years, when the deposits were received, no certainty that the contracts would be completed, perhaps particularly in 1938, in September of which year the Post Office citation was issued, that the money had not been earned, and the deposit was earnest money held in suspense; therefore the amounts did not constitute income. The respondent on his part in effect argues that the money had been received without restriction as to disposition or use, and was therefore gross income.

We note at once that one element of the petitioner's argument has no factual basis in the record: though he argues, on brief, that in the taxable year "As yet, he had done no work and performed no services whereby he earned the deposit", the record does not bear out such statement. Indeed, immediately prior to the above quoted language, he had stated that nothing had been done prior to the close of the year "other than to secure either a preliminary or final impression or to commence preparation of the first plate"—which shows on its face that at least some work had been done, something earned. This may well have reasonably been as much as or more than the \$2 deposit here involved. The record does not tell us what proportion that amount bore to the fee for the



finished product. Moreover, the evidence, by stipulation, is simply that on December 31, 1937, the deposits credited to the "deposit account" by the petitioner (and which were not returned as gross income by him) were "on orders which had not been filled or completed." Likewise the amounts left in the deposit account on December 31, 1938, were those "representing deposits on orders for dentures unfilled as of that date." An exhibit refers to the deposits on hand at the close of each year as "on orders not completed as yet." This constitutes all the evidence on the point. Obviously this is no showing that the \$2 deposits had not been earned during the year, merely because orders had not been "filled" or "completed." The burden being upon the petitioner, we hold that no showing is made that the deposits had not been earned during the respective taxable years. Yet the petitioner seems to recognize this point of fact as decisive, for on reply brief he says:

The question before this Board is whether petitioner did anything in the respective years of receipt whereby he became entitled to the deposits, as *earnings*. Here the facts operated to place the status of the deposits, as *earnings*, in suspense throughout the respective years of receipt. \* \* \*

Shortly after this appear the statements quoted above to the effect that the deposits had not been earned at the end of the year. We consider it clear that there is no showing that the deposits had not been earned. The only question, then, is the effect of an agreement to return them in case of dissatisfaction. That agreement covered not only the \$2 deposits, but the entire amount received, and no claim is made that the petitioner's argument applies to more than the \$2 deposits, the balance being returned as income. The argument could, ~~when~~ limited, as we have limited it, to the effect of the written agreement to return in case of dissatisfaction, be applied to petitioner's entire income with equal logic.

The petitioner cites *Webb Press Co., Ltd.*, 3 B. T. A. 247. That case involved a contract for sale of a cotton compress, where title was retained until acceptance, which did not occur until the next year, so that we held the money received in advance to be income in the following year. The case is of little help here, where there is no title retention and no question of acceptance. Here the customer merely has a right to return of his money if dissatisfied. *Bourne v. Commissioner*, 62 Fed. (2d) 648, also cited, is a

similar case, where there was advance payment or  
38 "earnest money" on a contract to sell real estate,  
where title did not pass and deed was not delivered  
until a later year, in which it was held the payment con-  
stituted income. We think such cases do not control here,  
where there is found only agreement to refund, not a re-  
tention of title or a contract not accepted. The same in  
effect is true of *Virginia Iron, Coal & Coke Co. v. Com-  
missioner*, 99 Fed. (2d) 919; and *Reginald Denny*, 33  
B. T. A. 738, involved a loan, neither paid nor received as  
income. Here, we think, the \$2 was both so paid and re-  
ceived. It was deposited by the petitioner in his only bank  
account, subject to his check and disposition, and, in our  
opinion, it was, as we said in *D. H. Byrd*, 32 B. T. A. 568,  
572, "subject only to an unliquidated contingent liability."  
It was received "under a claim of right and without re-  
striction as to its disposition." *North American Oil Con-  
solidated v. Burnet*, 286 U. S. 417; *Brown v. Helvering*, 291  
U. S. 193. The petitioner seeks to distinguish these two  
cases, cited by the respondent, by the suggestion that there  
was no earning in the taxable year. We have above noted  
that there is no such proof in the record. The contract to  
refund was in effect that this would be done if there was  
dissatisfaction after a trial of 60 days. Such agreement,  
in our opinion, does not demonstrate that gross income  
does not include money received upon the contract. That  
the petitioner might discontinue business because of the  
fraud orders does not require a different conclusion. On  
this point the respondent is not shown to have erred.

2. Was there error in refusing deduction of attorney  
fees paid in connection with the fraud order issued by the  
Postmaster General and finally unsuccessful effort to ob-  
tain a permanent injunction against it? The respondent  
cites that line of cases which holds, in sum, that expense  
for attorney fees is not ordinary and necessary if paid to  
defend, unsuccessfully, a criminal case, where there is con-  
viction, or expense of paying fines. The petitioner seeks to  
distinguish the situation herein from that involved in such  
cases, on the ground that here remedies afforded him by  
the law were asserted, and that there was no judicial de-  
termination of wrongdoing or admission of illegality.  
Here the Solicitor of the Post Office Department issued a  
citation for fraud order, under a statute so authorizing if  
he has evidence satisfactory to him that any person is  
engaged in conducting any scheme or device for obtaining

money or property through the mails by means of false or fraudulent pretenses, representations, or promises. Petitioner unsuccessfully expended money in 1937 for attorney fees in resisting the citation issued. The Postmaster General in 1938 issued the fraud order, the petitioner secured a permanent injunction in the United States District Court against the order, but upon appeal there was reversal,

39 the Circuit Court of Appeals specifically holding that the sole question before it was whether there was substantial evidence before the Postmaster General warranting the issuance of the fraud order, that his conclusion was presumptively correct, that the judgment of the court could not be substituted for that of the Postmaster General, and that there was substantial evidence before the Postmaster General; therefore the reversal. In 1938 the petitioner expended moneys for attorney fees to secure the injunction, and to defend the appeal and unsuccessfully apply to the Supreme Court of the United States for certiorari. The amounts expended are stipulated to be reasonable. Are they allowable as ordinary and necessary expense of trade or business?

After careful consideration of this somewhat novel question we have come to the conclusion that the petitioner is not entitled to the deduction claimed. *National Outdoor Advertising Bureau v. Helvering*, 89 Fed. (2d) 878, in our opinion governs this case. There a bill in equity was filed by the Attorney General of the United States to enjoin certain matters which he thought unlawful. A consent decree in equity issued forbidding the acts, but not finding that they had been committed. The Board of Tax Appeals considered that, since there was no evidence of commission of criminal acts and since the decree had been directed to acts in the future, expenses incurred in defense of the suit should be deducted. Upon appeal the Circuit Court, reversing the Board, said:

\* \* \* If it is never necessary to violate the law in managing a business, it cannot be necessary to resist a decree in equity forbidding violations, except in cases where an injunction is unjustified. \* \* \*

Herein also we find proceedings not under the criminal statutes, the first, resistance to a "fraud order" citation by the Postmaster General, and the second, an injunction proceeding by the petitioner to enjoin such order after its issuance. Though here there was no consent involved in

the fraud order or the final opinion denying injunction, nevertheless there was a holding by the Postmaster General that the practice complained of existed, and a sustention thereof by the Circuit Court. It is as if in the *National Outdoor Advertising* case there had been a decree of injunction on the merits, without consent. We think that opinion is based upon the fact of decree, and not the consent. The court seems to be of the opinion that if a decree of injunction is justified where there is a contention of unlawful practice, the expense is not deductible as ordinary and necessary expense. That the practices herein complained of by the Postmaster General were unlawful is demonstrated by examination of the Federal statutes: The fraud order was issued under sections 259 and 732 of Title 39, U. S. Code Annotated. The part thereof pertinent here is:

The Postmaster General may, upon evidence satisfactory to him \* \* \* that any person or company is conducting any other scheme or device for obtaining money or property of any kind through the mails by means of false or fraudulent pretenses, representations, or promises \* \* \* [act to bar the use of the mails or forbid payment of money orders, etc.]

The language is the same in the two statutes. But the same expression is the gist of a *criminal* statute. Section 338 of Title 18, U. S. Code Annotated, provides that:

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises \* \* \* shall \* \* \* place \* \* \* any letter \* \* \* in any post office \* \* \* shall be fined not more than \$1,000 or imprisoned not more than five years, or both.

In other words, the use of the mails in any scheme for obtaining money or property by means of false or fraudulent pretenses, representations, or promises is ground for barring from the mails, and for criminal prosecution. Though no criminal prosecution is suggested in the proceeding, it is apparent that the ground for the fraud order was the unlawful character charged to the practices of the petitioner. Use of the mails for lawful purposes would be no logical basis for a fraud order. We therefore think that injunction against unlawful practices appears here just as in the *National Outdoor Advertising* case. That case certainly



stands for the principle that a criminal case and conviction therein is not a necessary base for denial of deduction of legal expenses involved, but that a civil proceeding involving injunction against practice forbidden by law, unsuccessfully defended, calls for such denial. The reversal of the Board's view in that case, in our opinion, requires denial of the petitioner's contention here, as is shown by the fact that deduction of expense was allowed by the court in so far as the defense was successful. We cited the *National Outdoor Advertising* case in *Textile Mills Securities Corporation*, 38 B. T. A. 623, 631. The proceeding in which the legal expenses are involved need be only civil, such as injunction. Such proceeding here appearing, we conclude and hold that the respondent did not err in denying the claim of deduction for legal expenses in either year.

*Decision will be entered for the respondent.*

Entered  
June 13,  
1942.

41

UNITED STATES BOARD OF TAX APPEALS.

\* \* (Caption—106518) \* \*

### DECISION.

Pursuant to the determination of the Board, as set forth in its opinion promulgated June 10, 1942, it is

Ordered and Decided: That there are deficiencies in income tax for the calendar years 1937 and 1938 in the respective amounts of \$10,816.62 and \$4,359.39.

Entered June 13, 1942.

(Seal)

(Signed) R. L. Disney,  
Member.

42 BEFORE THE UNITED STATES BOARD OF TAX APPEALS.

Filed  
Aug. 13,  
1942.

S. B. Heininger,	}	B.T.A. No. 106518.
<i>Petitioner,</i>		
<i>vs.</i>		
Commissioner of Internal Revenue,		
<i>Respondent.</i>		

PETITION FOR REVIEW BY THE UNITED STATES  
CIRCUIT COURT OF APPEALS FOR THE SEV-  
ENTH CIRCUIT AND STATEMENT OF POINTS.

(Filed August 13, 1942.)

To the Honorable, the Judges of the United States Court  
of Appeals, for the Seventh Circuit:

I.

Jurisdiction.

S. B. Heininger, your petitioner, respectfully petitions this Honorable Court to review the decision of the United States Board of Tax Appeals entered on June 13, 1942, finding deficiencies in income tax due from petitioner for the calendar years 1937 and 1938 in the respective amounts of \$10,816.62 and \$4,359.39.

Your petitioner, at the time of filing this petition, is a citizen of the United States and resides at Athens, Wisconsin.

43. The returns of income tax, in respect to which the said alleged income tax liability arose, were filed by petitioner with the Collector of Internal Revenue for the First Collection District of Illinois, in the City of Chicago, State of Illinois, which is located within the jurisdiction of the Circuit Court of Appeals for the Seventh Judicial Circuit.

Jurisdiction of this Court to review the decision of the United States Board of Tax Appeals is founded on Section 1141 of the Internal Revenue Code (U. S. C. Title 28, Sec. 346).

## II.

## Nature of Controversy.

During the years from 1928 to 1939, petitioner was a licensed dentist, maintaining a laboratory and place of business at Chicago, Illinois. His only occupation during the taxable years involved was the making of artificial dentures, commonly called false teeth, for customers living outside of the State of Illinois, who did not personally visit petitioner's office. This business was conducted by mail in the following manner. The petitioner advertised throughout the United States, and upon receiving inquiries by mail petitioner mailed to each prospective customer printed matter descriptive of the artificial dentures manufactured by him, a price list, an order form, and a portion of wax called "first impression material," with instructions as to the use of the wax. Generally the customer then returned by mail the wax material on which he had made an oral impression, returning also an executed order blank accompanied by a \$2.00 deposit. This order blank designated the type of denture to be manufactured, and provided that when the plate or plates were finished, that the same should be sent C.O.D. for the balance of the purchase price. When satisfactory impressions were obtained petitioner manufactured and sent the plate or plates C.O.D. for the unpaid purchase price. Petitioner rendered no personal dentistry service in his office in Chicago or elsewhere, and accepted no orders originating from places within the State of Illinois. His sole occupation was the sale by mail order methods of artificial dentures to persons residing outside of the State of Illinois.

On September 22, 1937, a citation was issued by the Solicitor of the Post Office Department, charging that petitioner was engaged in conducting a scheme to obtain funds through the mails by means of false and fraudulent practices, in violation of 39 U. S. C. A., Sections 259 and 732. Petitioner thereupon appeared before the Post Office Department, answered said charges and employed attorneys to resist the issuance of a so-called "fraud order" under said statute. During 1937 petitioner paid attorneys' fees and other legal expenses in connection with said proceeding amounting to \$7,069.99. It is agreed that these payments were reasonable in amount.

On February 19, 1938, the Postmaster General of the United States issued a so-called "fraud order," forbidding the Postmaster at Chicago, Illinois, to pay any money orders drawn to the order of petitioner, and instructed said Postmaster to return all mail addressed to the petitioner to the sender, marked "Fraudulent." On February 25, 1938, petitioner filed suit in the District Court of the United States for the District of Columbia against James A. Farley, Postmaster General, and on that date said Court entered an order directing the Postmaster General to hold all mail addressed to petitioner until the further order of the Court. From February 19, 1938 until June 6, 1938, petitioner ceased doing business.

On June 6, 1938 the District Court of the United States for the District of Columbia granted petitioner a permanent injunction, restraining the Postmaster General of the United States from enforcing the so-called "fraud order." On or about June 6, 1938, petitioner resumed his business and continued to manufacture and sell false teeth by mail. On April 17, 1939, the Court of Appeals for the District of Columbia, on appeal by the Postmaster General, reversed the order of the District Court and remanded the case 46 with instructions to dissolve the injunction and dismiss the Bill of Complaint. Subsequent to that decision petitioner ceased to manufacture and sell false teeth by mail.

In the October Term, 1939, petitioner applied to the Supreme Court of the United States for a Writ of Certiorari to review the judgment of the United States Court of Appeals, which petition for Certiorari was denied. During 1939 petitioner paid to attorneys for legal services in connection with the injunction suit in the District Court, in defending the aforesaid appeal in the Circuit Court of Appeals for the District of Columbia, and in applying to the Supreme Court of the United States for a Writ of Certiorari, fees and legal expenses aggregating \$29,530.56. It is agreed that these payments were reasonable in amount.

Upon reviewing petitioner's income tax returns for the years 1937 and 1938, the Commissioner of Internal Revenue erroneously disallowed the deductions for attorneys' fees in the respective amounts of \$7,069.99 and \$29,530.36 paid by petitioner in the years 1937 and 1938. The Board of Tax Appeals held that the said attorneys' fees and legal expenses were not an ordinary and necessary expense of petitioner's trade or business, and sustained the determination of the Commissioner of Internal Revenue.

*Statement of Points.*

In making said decision, the United States Board of Tax Appeals committed the following errors upon which your petitioner relies as the basis of this proceeding:

1. The Board erred in failing to find and conclude that the amounts paid by petitioner in 1937 for attorneys' fees and legal expenses in resisting the issuance of the so-called "fraud order" were ordinary and necessary business expenses within the meaning of Section 23 (a) of the Revenue Act of 1936, as amended, and further erred in failing to sustain the petitioner's right to deduct said payments for attorneys' fees and legal expenses amounting to \$7,069.99 from income in his income tax return for the year 1937.

2. The Board erred in failing to find and conclude that the amounts paid by petitioner in 1938 for attorneys' fees and legal expenses in resisting the issuance of the so-called "fraud order" and seeking to have it set aside were ordinary and necessary business expenses within the meaning of Section 23 (a) of the Revenue Act of 1938, as amended, and further erred in failing to sustain the petitioner's right to deduct said payments for attorneys' fees and legal expenses amounting to \$29,530.36 from income in his income tax return for the year 1938.

48 3. The Board erroneously gave to the administrative proceedings conducted by the Post Office Department and to the issuance of the so-called "fraud order" the effect of a judicial determination that petitioner was guilty of wrong-doing in the conduct of his mail order business, and erroneously concluded therefrom that petitioner was not entitled to deduct said payments of \$7,069.99 and \$29,530.36 for attorneys' fees and legal expenses from income in his income tax returns for said years.

4. The Board erred in failing to find and conclude that the Post Office Department proceeding was merely an administrative proceeding which can be given no effect whatever in determining petitioner's right to take the deductions in question. The Board should have found and concluded that the petitioner was entitled to deduct the attorneys' fees and legal expenses paid in 1937 and 1938 in the exercise of legal remedies afforded him by law in resisting the issuance of said so-called fraud order, and in



applying to the courts to restrain the enforcement of that order.

5. The Board erroneously considered itself bound by the authority of the case of *National Outdoor Advertising Bureau v. Helvering*, 89 Fed. (2d) 878, the facts of which case are inapplicable to the present proceeding, and the law of which case is in conflict with decisions of Courts of Appeal of other Circuits.

49 6. The Board erred in failing to find and conclude that petitioner's sole business was the manufacture and sale of artificial dentures by mail; and the Board should have found that it was petitioner's only method of doing business, not merely an adjunct of petitioner's business, which the Postmaster General characterized as a scheme or device for obtaining money through the mail by false and fraudulent pretenses. Accordingly, giving the erroneous effect which it did to the so-called "fraud order" consistently the Board should have found and concluded that petitioner's business was illegal in its entirety.

7. The Board erred in failing to find and conclude that even if petitioner's business be viewed for the purpose of this proceeding as illegal in its entirety, petitioner was nevertheless entitled to deduct the aforesaid attorneys' fees and legal expenses paid by him in the years 1937 and 1938 as ordinary and necessary expenses of such business, since under Section 23 (a) of the Revenue Acts of 1936 and 1938 ordinary and necessary expenses of an illegal business are deductible.

8. The Board erred in sustaining the determination of the Commissioner of Internal Revenue whereby the Commissioner disallowed as deductions from income in the years 1937 and 1938 the said payments made by petitioner for attorneys' fees and legal expenses.

50 Wherefore, your petitioner prays that this Honorable Court may review the decision and order of the United States Board of Tax Appeals and reverse and set aside the said order in so far as the same disallows the deduction for attorneys' fees and legal expenses paid by petitioner in the years 1937 and 1938 aforesaid, and further prays that this Honorable Court reverse and set aside said order and direct said Board to enter an order finding and concluding that said deductions were lawful and proper and overruling the determinations of the Commissioner of Internal Revenue proposing income tax de-

*Statement of Points.*

iciencies based upon a disallowance of said deductions; and for the entry of such further orders and directions as shall by this Court be deemed meet and proper in accordance with law.

(Signed) Floyd Lanham,

(Signed) Samuel W. Witwer, Jr.,  
*Attorneys for Petitioner,*  
231 South La Salle Street,  
Room 1210,  
Chicago, Illinois.

State of Illinois, {  
County of Cook. } ss.

Samuel W. Witwer, Jr., being first duly sworn, says:

I am one of the attorneys for the petitioner in this proceeding; I prepared the foregoing petition and am  
51 familiar with the contents thereof. The allegations of fact contained therein are true to the best of my knowledge, information and belief. This petition is not filed for the purpose of delay and I believe that the petitioner is justly entitled to the relief sought.

(Signed) Samuel W. Witwer, Jr.

Subscribed and sworn to before me this 27th day of August, A. D. 1942.

(Signed) Lolita A. Conway,  
Notary Public.

(Seal)

My commission expires March 19, 1944.

State of Illinois, }  
County of Cook. } ss.

Floyd L. Lanham, being first duly sworn, says:  
I am one of the attorneys for the petitioner in this proceeding; I assisted in the preparation of the foregoing petition and am familiar with the contents thereof. The allegations of fact contained therein are true to the best of my knowledge, information and belief. This petition is not filed for the purpose of delay and I believe that the petitioner is justly entitled to the relief sought.

(Signed) Floyd Lanham.

Subscribed and sworn to before me this 27th day of August, A. D. 1942.

(Signed) Lolita A. Conway,  
Notary Public.

(Seal)

My commission expires March 19, 1944.

53 IN THE UNITED STATES CIRCUIT COURT OF APPEALS

Filed  
Sept. 3,  
1942.

For the Seventh Circuit.

S. B. Heininger,  
*Petitioner on Review.*

vs.

Commissioner of Internal Revenue,  
*Respondent on Review.*

B. T. A. Docket  
No. 106518.

NOTICE OF FILING PETITION FOR REVIEW AND  
STATEMENT OF POINTS.

(Filed Sept. 3, 1942.)

To: J. P. Wenchel, Chief Counsel,  
Bureau of Internal Revenue.

You are hereby notified that S. B. Heininger did, on the 31st day of August, 1942, filed with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Seventh Circuit, of the decision of the

*Designation of Record.*

Board heretofore rendered in the above entitled case. Copies of the petition for review and the statement of points as filed are hereto attached and served upon you.

Dated this 1st day of Sept. 1942.

B. D. Gamble,  
B. D. Gamble,  
*Clerk U. S. Board of  
Tax Appeals.*

Service of copy of Petition for Review and Statement of Points acknowledged this Sept. 2, 1942.

J. P. Wenchel,  
*Bureau of Internal Revenue,  
Attorney for Respondent.*

Filed 54  
Sept. 28,  
1942.

UNITED STATES BOARD OF TAX APPEALS.

(Caption—106518)

# **DESIGNATION OF RECORD TO BE INCLUDED IN THE RECORD ON APPEAL.**

(Filed Sept. 28, 1942.)

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, copies duly certified as correct of the following documents and records in the above entitled cause in connection with the Petition for Review by the said Circuit Court of Appeals for the Seventh Circuit, heretofore filed by the above named petitioner:

1. Docket entries of the proceedings before the Board.
2. Petition filed on February 26, 1941 and the document referred to in Paragraph 2 thereof as Notice of Deficiency (a copy of which was attached to said Petition and marked Exhibit A).
- 55 3. Answer filed April 10, 1941.
4. Findings of Fact and the Opinion of the Board promulgated on June 10, 1942.
5. Order of Re-Determination entered June 13, 1942.
6. Petition for Review filed as of August 31, 1942.
7. Proof of Service of Copy of Petition for Review upon Respondent.

8. Statement of Evidence filed as of August 31, 1942 including Petitioner's Exhibits 3, 4 and 5 attached thereto.

9. Designation for Record.

10. Notice of Filing Designation for Record and the admission of service thereof.

said transcript to be prepared as required by law and the rules of the United States Circuit Court of Appeals for the Seventh Circuit.

Floyd L. Lanham,  
Samuel W. Witwer, Jr.,  
*Attorneys for Petitioner.*

56 UNITED STATES BOARD OF TAX APPEALS.

• • (Caption—106518) • •

Filed  
Oct. 5,  
1942.

**NOTICE OF FILING OF DESIGNATION OF RECORD  
TO BE INCLUDED IN THE RECORD ON APPEAL.**

(Filed Oct. 5, 1942.)

To: J. P. Wenchel,  
Chief Counsel,  
Bureau of Internal Revenue,  
Internal Revenue Building,  
Washington, D. C.

Please take notice that on the 26th day of September, A. D. 1942, the undersigned attorneys for S. B. Heininger, petitioner in the above entitled proceedings, have filed with the Clerk of the United States Board of Tax Appeals, a Designation of Record to be included in the Record on Appeal, a copy of which is annexed hereto.

Floyd L. Lanham,  
Samuel W. Witwer, Jr.

Dated: September 26, 1942.

Receipt of the foregoing Notice of Filing of Designation of Record and service of a copy of the Designation of Record herein mentioned, is acknowledged this 23rd day of September, A. D. 1942.

J. P. Wenchel,  
*Chief Counsel, Bureau of Internal  
Revenue, Attorney for Respond-  
ent.*



57 " UNITED STATES BOARD OF TAX APPEALS.  
• • (Caption—106518) • •

**CERTIFICATE.**

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 55, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praeceptum in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 5th day of October, 1942.

(Seal)

B. D. Gamble,  
*Clerk, United States Board  
of Tax Appeals.*

IN THE UNITED STATES CIRCUIT COURT OF  
APPEALS FOR THE SEVENTH CIRCUIT

No. 8130

October Term, 1942, January Session, 1943

S. B. HEININGER, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for Review of Decision of the United States Board of  
Tax Appeals

February 15, 1943.

Before SPARKS, MAJOR, and MINTON, Circuit Judges

MINTON, Circuit Judge. The petitioner, S. B. Heininger, seeks to review a judgment of the United States Board of Tax Appeals which found the petitioner liable for deficiencies in income taxes for the years 1937 and 1938.

The petitioner, a dentist, conducted a mail order business in which he undertook to make false teeth and supply them by mail. The Post Office Department instituted a fraud order proceeding against the petitioner, which resulted in a finding that his methods were fraudulent, and an order against him denying to him the use of the mails. If he could not use the mails, he was out of business. Consequently, he filed suit in the District Court for the District of Columbia against the Postmaster General, and obtained a permanent injunction against him from enforcing the fraud order. On appeal to the Circuit Court of Appeals for the District of Columbia, the judgment of the District Court was reversed, and the fraud order of the Post Office Department was sustained.

In the defense of his business in the proceedings in the Post Office Department and the District Court and the Circuit Court of Appeals, the petitioner incurred and paid several thousand dollars for attorneys' fees and expenses. It is admitted that the expenses were reasonable. By these legal proceedings, the enforcement of the fraud order was enjoined and remained enjoined until the reversal by the Circuit Court of Appeals.

During this time, in the years 1937 and 1938, the petitioner continued in business and returned a gross income for 1937 of \$287,582.82, and for 1938 of \$150,168.27. While his litigation was ultimately unsuccessful, it did allow him to keep his business going

in 1937 and 1938, and enabled him to earn the large income indicated above.

The petitioner sought to deduct from his gross income for 1937 and that for 1938, as an ordinary and necessary expense of carrying on that business, the attorneys' fees and expenses of the litigation. The Commissioner disallowed the deduction, and the Board of Tax Appeals affirmed. The question is: Are such expenses deductible as ordinary and necessary expenses in carrying on that business, within the meaning of Section 23 (a) (1), 26 U. S. C. A., 49 Stat. 1648?<sup>1</sup>

What is an ordinary expense is discussed by Mr. Justice Cardozo in *Welch v. Helvering*, 290 U. S. 111, 114, 54 S. Ct. 8, 78 L. Ed. 212:

"Ordinary in this context does not mean that the payments must be habitual or normal in the sense that the same taxpayer will have to make them often. A lawsuit affecting the safety of a business may happen once in a lifetime. The counsel fees may be so heavy that repetition is unlikely. None the less, the expense is an ordinary one because we know from experience that payments for such a purpose, whether the amount is large or small, are the common and accepted means of defense against attack."

By this standard, we think it plain that the expense in the instant case was ordinary. It was such an expense as related strictly to the life of the business.

Not only must the expense be ordinary; it must also be necessary. In *Kornhauser v. United States*, 276 U. S. 145, 153, 48 S. Ct. 219, 72 L. Ed. 505, Mr. Justice Sutherland, in discussing the allowance, as a deduction, of attorneys' fees as a business expense, said:

"\* \* \* Where a suit or action against a taxpayer is directly connected with, or, as otherwise stated, \* \* \* proximately resulted from, his business, the expense incurred is a business expense within the meaning \* \* \* of the act."<sup>2</sup>

We think that where an expense is incurred which saves the life of a business, even for a time, it is, in the light of the above interpretation, not only a business expense, but a necessary business expense. Without the expenditure, there would have been no income in this case because there would have been no business. The Business depended directly upon the expense incurred in the litigation. We therefore hold that the expense was both ordinary and necessary.

<sup>1</sup> "Section 23. Deductions from gross income.—In computing net income there shall be allowed as deductions:

"(a) Expenses.

"(1) In general.

"All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business \* \* \*

<sup>2</sup> The provisions of the Act referred to are identical with those of Sec. 23 (a) (1) under consideration.

Our conclusion is supported by the case of *Foss v. Commissioner*, 75 F. (2d) 326, 1st Circuit, and *Gravel Company v. Commissioner*, 95 F. (2d) 615, 616, 5th Circuit. In the *Foss* case, *Foss* was the owner of stock in the American Blower Company and the B. F. Sturtevant Company. He was sued by the minority stockholders of the American Blower Company, and charged with entering a combination to divert the business of that company to the B. F. Sturtevant Company, and to violate the Sherman Act. The District Court sustained the charges, and granted relief. The Circuit Court of Appeals modified the relief granted, but otherwise sustained the District Court. *Foss* incurred large attorneys' fees, which he sought to deduct from his income as ordinary and necessary expenses of his business. This deduction was disallowed by the Board of Tax Appeals, but on appeal to the Circuit Court of Appeals, the deduction was allowed, the court relying upon *Kornhauser v. United States*, *supra*.

In the *Gravel Company* case, the Board of Tax Appeals had refused to allow the company to deduct, as an ordinary and necessary expense of its business of selling gravel, commissions paid to one Dore on sales to the State Highway Commission. The disallowance was because of the fact that Dore was a State Senator. There was no evidence that he was to use or did use his political influence to obtain contracts with the Highway Commission, as all of the contracts were let by competitive bidding. The Circuit Court of Appeals reversed the Board of Tax Appeals, and said:

"The revenue laws of the United States are not over-squeamish. By the broad definition of gross income, income arising from an illegal business is taxed even though the illegality be one declared by the Constitution itself. *United States v. Sullivan*, 274 U. S. 259, 47 S. Ct. 607, 71 L. Ed. 1037, 51 A. L. R. 1020. The provisions of the statute fixing the deductions to be regarded in arriving at the net income which alone is taxed, 26 U. S. C. A. Sec. 23, are as broad and unqualified as those defining the taxable gross income. Ordinary and necessary expenses of an illegal business would therefore seem to be deductible if they would have been had the business not been prohibited."

The Board of Tax Appeals based its decision in the instant case upon *National Outdoor Advertising Bureau v. Helvering*, 89 F. (2d) 878. In that case, the taxpayer was charged with a violation of the Sherman Act. As to part of the charges, the taxpayer defended successfully. As to the balance, it agreed to a consent decree. The taxpayer sought to deduct attorneys' fees incurred and paid in this litigation. The Circuit Court of Appeals approved a deduction as to the attorneys' fees and expenses incurred and paid in successfully defending certain of the charges,

but denied the right to deduct for legal expenses incurred and paid in negotiating the settlement and drafting the consent decree. The court held in effect that an expense cannot be necessary if incurred in the defense of an unlawful business. We are not inclined to follow this case.

The Government also relies strongly upon *Textile Mills Corp. v. Commissioner*, 314 U. S. 326, 62 S. Ct. 272, 86 L. Ed. 242, where a corporation sought to deduct certain lobbying expenses. Such expenses were clearly prohibited as a deduction by the Treasury Regulations which provided, "Sums of money expended for lobbying purposes \* \* \* are \* \* \* not deductible from gross income." The Supreme Court held that this was a proper regulation for the purpose of carrying out the provisions of the statute.

For many years, the Bureau of Internal Revenue has taxed the income of illegal business in the same manner as the income of legal business. *United States v. Sullivan*, 274 U. S. 259, 47 S. Ct. 607, 71 L. Ed. 1037. Although this provision was known to Congress, it still made no change in the law so as to subject the income of illegal business to a treatment different from that of legal business. Both, so far as the statutes and the regulations of the Department went, were to be taxed on their net income. If the position of the respondent is sustained, and the attorneys' fees and expenses disallowed as a deduction in the instant case, then no business expense of an illegal business is deductible, and such business would be taxable on its gross income. Congress has not said that that discrimination shall be made. Neither has the Department had the hardihood to make such a material change by way of its regulations. If this change is to be made and the policy altered, let Congress do it. Congress would need only to add the word "legal" before the word "trade" in the third line of Section 23 (a) (1).

We are asked, in the guise of construing the words "ordinary and necessary," to amend the statute. In other words, to engage in a little judicial legislation. We decline the invitation.

If the deduction in the case at bar was not an ordinary and necessary expense to the "carrying on" of the business, we are unable to understand the English language. Without this expense, there would have been no business. Without the business, there would have been no income. Without the income, there would have been no tax. To say that this expense is not ordinary and necessary is to say that that which gives life is not ordinary and necessary.

The judgment of the Board of Tax Appeals is reversed.



And on the same day, to wit: On the fifteenth day of February 1943, the following further proceedings were had and entered of record, to wit:

Monday, February 15, 1943

Court met pursuant to adjournment

Before Hon. WILLIAM M. SPARKS, Circuit Judge; Hon. J. EARL MAJOR, Circuit Judge; Hon. SHERMAN MINTON, Circuit Judge.

No. 8130

S. B. HEININGER, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for Review of Decision of the United States Board of Tax Appeals

This cause came on to be heard on the transcript of the record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof: It is ordered and adjudged by this Court that the Decision of the United States Board of Tax Appeals entered in this cause on June 13, 1942, be, and the same is hereby, reversed, and that this cause be, and the same is hereby, remanded to the United States Board of Tax Appeals.

United States Circuit Court of Appeals for the Seventh Circuit

I, Kenneth J. Carrick, Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, do Hereby certify that the foregoing typewritten pages contain a true copy of the Opinion of the Court, filed on the fifteenth day of February 1943, and the Judgment entered on the same date, in Cause No. 8130, S. B. Heininger, Petitioner vs. Commissioner of Internal Revenue, Respondent, as the same remains upon the files and records of the United States Circuit Court of Appeals for the Seventh Circuit.

In testimony whereof I hereunto subscribe my name and affix the seal of said United States Circuit Court of Appeals for the Seventh Circuit, at the City of Chicago, this 29th day of April A. D. 1943.

[SEAL]

KENNETH J. CARRICK,

*Clerk of the United States Circuit Court  
of Appeals for the Seventh Circuit.*

## Supreme Court of the United States

*Order allowing certiorari*

(Filed June 14, 1943)

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit is granted, and the case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.